UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 67781 / September 5, 2012

INVESTMENT ADVISERS ACT OF 1940
Release No. 3456 / September 5, 2012

INVESTMENT COMPANY ACT OF 1934
Release No. 30193 / September 5, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15006

In the Matter of

RAYMOND J. LUCIA COMPANIES, INC. and RAYMOND J. LUCIA, SR.,

Respondents.

RESPONDENTS RAYMOND J. LUCIA, SR. AND RAYMOND J. LUCIA COMPANIES, INC.'S PREHEARING BRIEF

Respondents Raymond J. Lucia, Sr. ("Lucia") and Raymond J. Lucia Companies, Inc. ("RJLC")(collectively, "Respondents") hereby respectfully submit their Prehearing Brief.

INTRODUCTION

The Order Instituting Proceedings ("OIP") against Respondents alleges violations of Sections 206 and 204 of the Advisers Act in connection with a PowerPoint slide presentation used by Lucia during seminars explaining his retirement planning strategy, "Buckets of Money"® ("BOM"). In asserting their allegations, the Securities and Exchange Commission's ("SEC") Division of Enforcement ("Division") seeks to apply Section 206 and 204 in a manner that has never been articulated or addressed in any reported decision, is a sea change to the current "facts and circumstances" test to determine whether an advertisement is misleading, and is far beyond the scope of any settled case, SEC no-action letter or interpretation. In sum, the standard the Division is now advocating would render an investment advisor subject to a scienter based violation of the Advisers Act as the result of not applying actual annual historical data to an illustration in a PowerPoint presentation that did not promote any portfolio, security or investment and that served as a backdrop for a seminar discussion of retirement withdrawal strategies.

The Division asserts that RJLC willfully violated and Lucia willfully aided and abetted RJLC's violation of Sections 201(1), 206(2) and 206(4) of the Advisers Act based entirely on the non-technical use of the term "Back Tested" on **one** slide of 127 slides presented during the BOM seminars. In instituting this Proceeding, the Division ignores that: 1) the slide at issue, and dozens of others in the slide presentation, clearly state that the scenarios presented are a "**hypothetical illustration;**"[1] 2) the clear and stated purpose of the hypothetical illustration presented was **not** to advertise the performance of any managed account or any securities recommendation, but instead to compare the asset longevity of the BOM retirement withdrawal strategy to other retirement strategies; 3) the hypothetical illustrations at issue could not have been "back tests" in the technical sense the Division seeks to apply as an investor could not have made the "investments" as described, i.e. an investment in the S&P 500; 4) during its 2003 examination of RJLC, the Staff reviewed identical seminar slides which have the exact issues the Division complains of in the OIP, including the use of the term "back test," and made no

1 The disclosure on the slide at issue states:
"This is a hypothetical illustration and is not representative of an actual investment. An investor's results may vary. Past performance does not guarantee future results. This example uses actual treasury rates of return to calculate fixed income/bond returns and actual S&P 500 returns to calculate growth returns. An investment may not be made directly in an index." (Respondents' Exhibit 3, SEC-LA3937-00200)

mention or determination of any potential deficiency or violation;[2] and, most importantly, 5) the seminar attendees did not see the slide presentation in a vacuum, but instead saw the slide presentation in conjunction with Lucia's oral presentation during which it was made clear to the attendees that the hypothetical illustrations were not intended to be "back tests" as that term is defined by the Division and its expert. The best evidence of the BOM seminar presentation is Respondents' Exhibit 30, a DVD of a BOM seminar which was aired on the Internet on February 16, 2009. Respondents' Exhibit 30 conclusively demonstrates that the seminar attendees were not misled by the hypotheticals at issue. The Division's attempt to exclude this tribunal from considering this evidence, the only recorded example of a BOM seminar, is both surprising and troubling, and can only be interpreted as a concession that the Division's case hinges on this Court ignoring the context in which the hypotheticals were presented.

With respect to the Division's assertion that RJLC violated Section 204 of the Advisers Act, that allegation must fail. The slides do not in any way calculate the "performance or rate of return of any or all managed accounts or securities recommendations" as Rule 204-2(a)(16)requires. Therefore, RJLC was not required to maintain or provide support for the calculations contained in the slides. The Division's allegation that RJLC was required to maintain books and records to demonstrate the performance of a hypothetical illustration comprised of investments in the S&P 500 (an investment cannot be made directly in an index); an unspecified real estate investment, and unidentified T-Bills defies a rational interpretation of

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2 Indeed, the Examination Report for the 2003 examination correctly states, that RJLC "**does not advertise performance**" and "is not responsible for placing or executing orders with respect to managed client accounts." (emphasis added) (Respondents' Exhibit 22, SEC-LA3937-1027)

Rule and every reported decision, no-action letter and order making findings that has interpreted Section 204. Accordingly, the Section 204 claim should be dismissed.[3]

Lucia has presented his BOM retirement withdrawal strategy at hundreds of seminars to more than 30,000 attendees throughout the country for almost two decades. There are no allegations, nor can there be, that prior to the filing of the OIP, any attendee has ever complained that he or she was "misled" during a seminar or that he or she suffered any monetary damage as a result of any seminar presentation.[4]

Following the Staff's 2010 examination of RJLC and upon receipt of the December 17, 2010 deficiency letter concerning, among others, the seminar slides, Respondents immediately ceased all use of the slides at issue. This is a matter that should have been resolved, as Respondents thought it had been, through the examination process. Given the absence of any financial irregularities and Respondents' immediate agreement to cease using the seminar slides at issue, the Division's blatant intent to destroy Lucia's business is revealed by the numerous unorthodox steps taken during the investigation including: 1) concealing the existence of the Formal Order while directing Respondents to provide documents and information in response to deficiency letters, 2) contacting and misrepresenting to clients of RJL Wealth Management ("RJLWM")[5] that RJLWM had provided their contact information to the Staff, 3) contacting

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3 Moreover, the slides at issue were not "circulated" or "distributed" (terms that are not defined in the Regulations) to any investor or potential investor. *See* Rule 204-2(a)(16). There do not appear to be any reported decisions where the SEC has taken the position that PowerPoint slides from a seminar which were not circulated or distributed to the seminar attendees are encompassed within the definition of Section 204-2(a)(16).

4 Months after Respondents made a Wells Submission, the Staff contacted The Guiliano Law Firm, which describes itself as "Securities Arbitration and Investment Fraud Lawyers," in an attempt to find seminar attendees to testify against Lucia in this Proceeding. The same day the OIP was filed, the Guiliano firm immediately posted on its website a solicitation for RJLC clients that falsely stated "SEC Charges Raymond Lucia and Lucia Wealth Management with Massive $300 Million Retirement Fraud." The Staff's attempts to troll for witnesses to build its case against Respondents should be noted.

5 Subsequent to the Staff's examination, RJLC's advisory accounts were sold at fair market value and transferred to RJLWM, an Independent Investment Advisory Firm offering financial planning and

plaintiff securities class-action law firms to find witnesses to testify against Lucia, 4) retaining an $800 per hour expert months before filing the OIP to opine that the hypothetical illustrations were not "back tests," and, 5) as revealed days before the hearing is scheduled to commence, issuing two 2010 Examination Reports, the first concluding that an enforcement referral was not recommended, and, without any justification therefor, a second referring RJLC to enforcement. The Division has utterly destroyed the professional reputation of Lucia, and irreparably damaged his business, thus jeopardizing the employment and livelihoods all the RJLC employees, many of whom have worked with Lucia for decades.[6] For the reasons set forth below, the OIP should be dismissed.

FACTUAL BACKGROUND

Lucia is the creator of the "Buckets of Money"® ("BOM") retirement withdrawal strategy. In its simplest terms, the BOM retirement withdrawal strategy is a liability driven strategy where assets are matched to one's income liability. BOM advocates investing in a "safe bucket" for initial spending needs during retirement and a long-term "growth bucket" to build retirement income to be spent after the safe bucket is depleted some years in the future, depending on each individual retiree's circumstances. Due to the short and intermediate term nature of fixed income investments, many times three or more buckets are used: Bucket 1 for immediate income (and depending on assets, lifetime annuitized income), Bucket 2 to replace Bucket 1 after a specified period and Bucket 3, the long term growth bucket, consisting of

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investment management services. RJLWM's investment advisor representatives ("IARs") also offer insurance products and securities. Lucia has no ownership interest in RJLWM. Lucia is now registered as an IAR with RJLWM. RJLC is no longer registered as an investment advisor and no longer has a fee arrangement with RJLWM.

[6] In the wake of the filing of the OIP, numerous news agencies, websites and blogs falsely reported that Lucia had "been indicted," and charged with "defrauding" retirees and "scamming" investors. At least three plaintiff securities firms, including two firms contacted by Staff from the Pacific Regional Office before the OIP was filed, created websites devoted to soliciting investors to sue Respondents.

diversified stocks and real estate investments with an approximate fifteen year time horizon. The BOM strategy encourages investors to spend down Buckets 1 and 2 first, thereby allowing the investments in Bucket 3 to grow. Under the BOM strategy, the longer the investments in Bucket 3 have to grow, the lower the risk of having to take distributions from a volatile portfolio during and after substantial declines in the stock market. The BOM strategy is, for example, an alternative to the "reallocation" or "portfolio rebalancing" approach utilized by many investment advisers.[7] In recent years, a significant number of investment advisers, academics and economists have begun advocating versions of the "spend safe money first" BOM strategy.[8]

Lucia has authored three books on the topic of retirement and the BOM strategy: Buckets of Money® How to Retire in Comfort & Safety (Wiley & Sons, 2004), Ready. Set. Retire! Financial Strategies for the Rest of Your Life (Hay House, 2007), and The Buckets of Money® Retirement Solution – The Ultimate Guide to Income for Life (Wiley & Sons, 2010).[9] Prior to the filing of the OIP, Lucia made numerous television appearances and had a syndicated radio show during which he discussed general economic trends and answered callers' questions on retirement, tax, investment and estate planning.[10] Lucia presents the BOM strategy during retirement distribution planning seminars held throughout the country, illustrating that the concept of withdrawing bonds or other safe investments over stocks or "safe money first," is a

7 The traditional asset allocation and portfolio rebalancing investment strategy sets the client's portfolio to a specific diversification allocation – 60/40 equities to fixed income is the classic example – and income withdrawals are managed around that standard.

8 *See*, S. Singh, J. Spitzer. 2007. "Is Rebalancing a Portfolio During Retirement Necessary?" *Journal of Financial Planning* June 2007 (Respondents' Exhibit 37); R. Irons, R. Wigand. 2008. "How Withdrawal Sequence Affects the Longevity and risk of retirees' Portfolios: Additional Evidence." *Journal of Financial Planning*, November 2008 (Respondents' Exhibit 38); Fox, N. 2012. "A Bucket Strategy for Retirement Income." *Forbes*, May 9, 2012 (Respondents' Exhibit 41).

9 The OIP does not contain any allegation that the books contain any misrepresentation or violate any section of the Advisers Act or any securities law. A review of each of Lucia's books demonstrates extensive disclosures and discussion concerning the issues the Division alleges Respondents failed to disclose. Similarly, the OIP does not include any allegation that Lucia's website or radio or television appearances in any way violate the Advisers Act or any other securities law.

10 After the OIP was filed, Lucia's personal appearance opportunities virtually disappeared.

better method than the traditional method of taking income from a more volatile portfolio and rebalancing the portfolio periodically.

Neither Lucia nor RJLC have ever been fined or disciplined by the Commission or any other regulatory body, nor the subject of any prior disciplinary action.

A. Lucia's BOM Seminar Presentation

The BOM seminars are free seminars featuring Lucia and marketed to retirees and those approaching retirement. During the seminar presentations, Lucia does not promote any specific stock, bond, mutual fund, annuity, real estate investment, or managed portfolio and does not make any promise or prediction as to the return on any investment portfolio. The majority of the BOM slideshow presentation is educational in nature, setting forth factors and risks relative to retirement planning. The BOM seminar presentation is readily distinguishable from, for example, advertised performance results based on client accounts or market timing models which show specific rates of return for specific time periods based on hypothetical mutual funds. At the conclusion of the seminar, attendees are invited to submit contact information to be contacted on a later date by an adviser. Approximately 15-30% of the attendees choose to be contacted by an adviser. If an attendee later meets with an adviser, he or she will be given a complementary BOM plan specific to his or her personal investment circumstances. Until a potential investor meets with an adviser, typically 3-4 weeks following a seminar, there is no discussion as to any specific investments or allocations.

The sole basis for the Division's allegations are two hypothetical illustrations previously shown in the BOM seminar PowerPoint presentation. The first is referred to in the slide presentation as the "'73/'74 Grizzly Bear" hypothetical illustration and compares the BOM withdrawal strategy to three other investment strategies, namely 1) a conservative strategy where the investors invest 100% in "safe" investments, CD's, money markets, bond funds, etc., 2) a more risky strategy where the investors invest 100% in the "stock market," and 3) a "balanced" strategy where the investments are 40% bonds and 60% stocks and withdrawn proportionately. (Respondents' Exhibit 3, RJL-SEC-000417-468; Respondents' Exhibit 30, 37:23-47:00) The purpose of the "'73/'74 Grizzly Bear" seminar hypothetical, as its name suggests, was to demonstrate that during a bear market, the BOM withdrawal strategy would outperform the other strategies. For this illustration, each strategy began with a $1 million portfolio and invested and withdrew funds in accordance with the particular strategy. The "'73/'74 Grizzly Bear" hypothetical demonstrated that by withdrawing retirement assets in accordance with the BOM strategy, the income lasted for a longer period of time and, therefore, the BOM strategy was superior to the comparison strategies. *Id.*

The purpose of the second hypothetical illustration was to compare BOM to the other strategies where stock market returns were stagnant for long periods of time. During the seminar, Lucia stated – "you remember how in 1966, the Dow Jones Industrial Average was hovering around 1,000 and in 1982, the Dow was still at about 1,000" – to demonstrate how the BOM withdrawal strategy compared to the other retirement investment strategies during a period of stagnant stock market returns. (Respondents' Exhibit 3, RJL-SEC-000469-478; Respondents' Exhibit 30, 47:21-50-36) As with the "'73/'74 Grizzly Bear" hypothetical, the BOM strategy produced greater returns for longer periods of time in comparison to the other three investment strategies, a fact conceded by the Staff.

The Division alleges that these hypotheticals violate Section 206 because: 1) the hypotheticals assumed a 3% inflation rate, 2) the hypotheticals assumed a REIT return rate,[11] and 3) advisory fees were not deducted.

B. Assumption of 3% Rate of Inflation

The Division asserts that certain slides used in the BOM seminar presentation comparing the BOM investment strategy with other investment strategies during a bear market (the "1973 hypothetical") and during a stagnant period in the stock market (the "1966 hypothetical") for the purpose of demonstrating that the "spend safe money first" or BOM withdrawal strategy is a sound approach to retirement withdrawal were misleading because a 3% inflation rate was assumed.

Respondents will present conclusive evidence that during the seminar, there were repeated disclosures that the illustrations were hypotheticals and Respondents' expert will testify that the assumed inflation rate was reasonable. Accordingly, the use of a disclosed "assumed" inflation rate in the hypothetical illustrations was not misleading and did not violate Section 206 of the Advisers Act.

C. Assumed REIT Rate of Return[12]

The OIP alleges it was misleading for Respondents to fail to disclose that the REIT rates of return were "entirely" hypothetical and "failed to disclose that using an assumed REIT return materially inflated the results of the purported backtesting." Respondents will introduce evidence at the hearing which will demonstrate that during the seminar, Lucia states that the

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[11] Based on deposition testimony in this proceeding, it appears the Division may attempt to introduce evidence on REIT related issues not alleged in the OIP. If so, Respondents will object at the appropriate time.

[12] Respondents were not given the opportunity to address the assumed REIT rate of return issue in their Wells Submission to the Commission because the Staff specifically advised counsel that an enforcement action would <u>not</u> include any purported violation based on assumed REIT rates of return.

"assumed REIT rate of return"[13] is "certainly not guaranteed" and is represented by a direct ownership in real estate, including traded and non-traded real estate investment trusts. Because he did not identify a specific real estate investment, it would be impossible to apply an actual historical rate of return in the manner urged by the SEC's expert. Given the general description of the REIT investment during the seminar, no reasonable investor would have thought Lucia was describing a specific REIT or that the assumed rate of return was based on a specific REIT investment.

Moreover, the 2010 examination deficiency letters (and one of the two 2010 examination reports) and the OIP do not take a position as to the REIT return rate Lucia should have utilized for the hypotheticals not to be misleading. Respondents will present conclusive evidence that during the seminar, there were repeated disclosures that the illustrations were hypotheticals and Respondents' expert will testify that the assumed REIT rate of return was reasonable. Accordingly, the use of a disclosed "assumed" REIT rate of return in the hypothetical illustrations was not misleading and did not violate Section 206 of the Advisers Act.

D. <u>Disclosure of Advisory Fees</u>

The OIP also asserts that the seminar slideshow hypotheticals were misleading because the effect of advisory fees was not disclosed. The slides at issue relate only to the BOM withdrawal strategy and do not, for example, relate to any specific investments or allocations. For that reason, it is implicit that advisory fees are not included in the hypothetical illustrations, although the fact that there could be fees and expenses associated with investments, was disclosed. (Respondents' Exhibit 3, RJL-SEC-000360) As discussed further below, Respondents are aware of no authority for the Division's position that Rule 206(4) requires a disclosure of

[13] The Oxford Dictionary defines "assume" as "suppose to be the case, without proof."

advisory fees in connection with a comparison of investment strategies, as opposed to model or actual performance results.

PROCEDURAL BACKGROUND

A. 2003 Examination

On August 23, 2003, Laura Coty, SEC Staff Accountant and Securities Compliance Examiner contacted Melissa Dotson of RJLC and advised her that the Pacific Regional Office would be examining RJLC the following week. In connection with the 2003 Examination, the Staff requested records and other information from RJLC, including a copy of "any promotional brochures, pamphlets, advertisements (e.g.), newspaper or magazine ads, radio scripts, reprints, etc.), or other materials used to inform or solicit clients during the inspection period. If Registrant makes information about its services available on the Internet, the address at which information is available" and any "composite or representative performance reports, data, or graphs currently disseminated to clients or prospective clients." (Respondents' Exhibits 15, 16)

In response, RJLC made available and the examiners reviewed the advertising materials, including the BOM seminar PowerPoint slides used by Lucia in 2003. The seminar slides that the Staff examiners reviewed during the 2003 examination include slides **identical** to the slides the Division now alleges are misleading. In fact, the **one slide** that the Division's expert has testified forms the basis of his entire opinion that investors were misled because of the single use of the term "back test" was reviewed by the Staff during the 2003 exam. (Respondents' Exhibit 3, SEC-LA3937-00200, Respondents' Exhibit 21, see also, Division Exhibit 21, SEC-LA3937-01094; Division Exhibit 22, SEC BD-002054) The slides for the hypotheticals reviewed during the 2003 examination also assume a 3% inflation rate, a 7.75% REIT dividend yield and do not show the effects of advisory fees. (Respondents' Exhibit 3, SEC-LA3937-0000417-478, Respondents' Exhibit 21, see also, Division Exhibit 21, SEC-LA3937-01079-01099; Division Exhibit 22, SEC BD-002020-2066) As such, the slides reviewed by the Staff in 2003 contain the identical issues the Division now alleges are the basis for this Proceeding.

Although the 2003 Examination staff requested and were provided copies of certain BOM seminar slides during the 2003 Examination, they did not request copies of or comment on the slides that contain the term "back test" or slides related to the "'73/'74 Grizzly Bear" hypothetical illustration. (Respondents' Exhibit 17-20) During the exit interview for the 2003 Examination, the Staff made no mention of the slides related to the "'73/'74 Grizzly Bear" hypothetical illustrations or the use of the term "back-test." Moreover, the December 12, 2003 deficiency letter sent to RJLC following the 2003 examination makes no mention of the seminar slide presentation and takes no issue with the term "back test," the assumed 3% inflation rate or REIT rate of return, or disclosure of advisory fees. Most importantly, the Investment Adviser Examination Report for the 2003 examination of RJLC states:

> . . . because Registrant contracts out its advisory services to third party sub –advisers via mutual fund asset allocation and wrap fee programs, the staff eliminated portfolio management from its review. Second, **because Registrant does not advertise performance**, the staff excluded performance advertising from the scope of the examination. Third, because Registrant is not responsible for placing or executing orders with respect to managed client accounts, the staff did not review personal securities transactions. (emphasis added) (Respondents' Exhibit 22, SEC-LA3937-1027)

The 2003 Examination Report also states, "In addition, Lucia conducts seminars, radio broadcasts, and television appearances nationwide on general investment and financial planning and the Buckets of Money strategy." (Respondents' Exhibit 22, SEC-LA3937-1034). In 2003, after examining the exact same seminar slides, and considering the BOM seminars, the Staff examination team concluded that RJLC **did not advertise performance** and was **not responsible for placing or executing orders with respect to managed client accounts.** *Id.*

Had the 2003 Examination Staff advised RJLC that they considered the slides misleading, or even potentially misleading, RJLC would immediately have pulled the slides from the seminar presentation – as it did with other slides during the course of and subsequent to the 2003 Examination and in December 2010 in response to the 2010 Examination deficiency letter.

B. <u>2010 Examination and Enforcement Action</u>

In March 2010, the Staff conducted an examination of RJLC as the "Adviser." The Staff's examination covered the period January 1, 2008 through January 31, 2010. RJLC responded to the Staff's examination request list and supplemental list. During the May 12, 2010 telephonic exit interview, the Staff presented and discussed with Theresa Ochs, Chief Compliance Officer, Brent Rivard, Chief Operating Officer and Chief Financial Officer, and Craig Nett, compliance officer, certain purported deficiencies and weaknesses identified during the examination. Immediately following and in response to this discussion, RJLC took certain actions. During the examination and the exit interview, the Staff gave Respondents no indication that there were any deficiencies that even potentially rose to a level that would support allegations of Advisers Act violations, or that would not be resolved upon receipt of the Staff's deficiency letter. Specifically, during the examination and exit interview, the Staff did not suggest that Lucia should cease using the slides.[14]

As recently revealed by the Division, following the 2010 Examination, an Examination Report was prepared and executed by, among others, the Associate Regional Director of the Pacific Regional Office on November 8, 2010 ("November 2010 Examination Report"). (Respondents' Exhibit 50, LA-SEC3937-005780) The November 2010 Examination Report states, "The staff sent deficiency letters to the Registrants, which discuss the issues summarized

[14] If the Staff had these concerns during the 2010 Examination, it is curious that the Staff knowingly allowed Lucia to continue presenting the slides at seminars for seven months before demanding that RJLC "cease disseminating misleading performance information."

above." This statement is false. Further, the November 2010 Examination Report does not conclude that RJLC should be referred to enforcement. The Division has represented that the November 2010 Examination Report is a "draft." Respondents assert that the November 2010 Examination is not a draft, but instead, is further evidence of selective prosecution of Respondents.

Five weeks after the November 2010 Examination Report was executed, the Pacific Regional Office issued a second 2010 Examination Report which was executed by the Associate Regional Director on December 16, 2010 ("December 2010 Examination Report"). (Respondents' Exhibit 51, LA-SEC3937-005801-5823). Without explanation, the December 2010 Report states that the staff has referred the "marketing issues" to the enforcement staff.

By letter dated December 17, 2010, over seven months following the examination, the Staff communicated to RJLC the purported weaknesses and deficiencies identified during the 2010 Examination. (Respondents' Exhibit 6). Upon receipt of the December 17, 2010, deficiency letter, Respondents took immediate action which included: 1) reviewing all marketing materials, including the website and the BOM seminar presentation materials, and removing all references to the terms "back tested" and "time tested;"[15] 2) removing from the BOM seminar slideshow the slides comparing the BOM strategy to the other retirement investment strategies;[16] and 3) ceasing distribution of the books authored by Lucia.

By letter dated February 1, 2011, RJLC responded in detail to each of the advertising issues raised in the examination Staff's December 17, 2010 deficiency letter. (Respondents' Exhibit 7) By letter dated February 14, 2011, RJLC responded in detail to the Compliance, Regulation S-P and Books and Records issues raised in the examination Staff's December 17,

15 RJLC has previously advised the Staff that these revisions were completed by January 14, 2011.

16 RJLC has previously advised the Staff that the last time Lucia publicly used or discussed the slides in question was November 20, 2010.

2010 letter. (Respondents' Exhibit 8) By letter dated March 17, 2011, the examination Staff responded to RJLC's February 1 and 14, 2011 letters, with an unhelpful and conclusory assertion that it disagreed with RJLC's factual positions, and requested copies of all materials related to a seminar held February 26, 2011 in Houston, Texas. (Respondents' Exhibit 9) By letter dated April 14, 2011, Respondents responded to the examination Staff's March 17, 2011 letter and provided the documents requested. (Respondents' Exhibit 10)

By subpoena dated May 11, 2011 in *In the Matter of RJL Companies, Inc.* (LA-3937), the Staff demanded the production of certain documents from RJLC. (Respondents' Exhibit 11) In response, RJLC requested a copy of the formal order of investigation. Upon receipt of the formal order dated December 2, 2010 ("Formal Order"), RJLC became aware, for the first time, that the Formal Order had been issued prior to the December 17, 2010 and March 17, 2011 deficiency letters and demands for written responses and documents.[17]

Accordingly, while Respondents were producing documents, responding to inquiries, taking corrective action and engaging in an on-going good faith attempt to resolve the issues set forth in the December 17, 2010 deficiency letter, the Staff was using the deficiency letters as a stalking horse to obtain documents and discovery which should have been requested in accordance with the Formal Order Process.[18] In their December 17, 2010 deficiency letter and follow on correspondence, the Staff repeatedly requested that Respondents furnish documentary evidence and provide written responses to matters that are now the subject of this proceeding and

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[17] Again, it is curious that as of the date the Formal Order was issued, the Staff still had not requested or demanded that Lucia cease using the slides at his seminars. If the Staff were concerned that investors or potential investors were being misled, one would think the Staff would have made the request.

[18] See Rule 7(a) of the SEC's Rules Relating to Investigations (Rights of Witnesses).

encompassed within the Formal Order. By doing so, the Staff violated the Respondents' due process rights and prejudiced their ability to defend this enforcement proceeding.

For example, the examination Staff's March 17, 2011 letter demanded, among other things, that RJLC 1) provide the Staff with a "detailed description of the policies and procedures it intends to implement in order to ensure future marketing will not raise any of the [advertising issues raised in the deficiency letter]"; and 2) "provide all presentation materials used or distributed by RJLC in conjunction with the February 26, 2011 Buckets of Money Seminar in Houston." By letter dated April 12, 2011, RJLC complied with both demands. Rule 7(a) of the SEC's Rules Relating to Investigations provides that any person who is compelled or required to furnish documents or testimony at a formal investigative proceeding shall, upon request, be shown the formal order of investigation. Respondents were precluded from requesting a copy of the Formal Order prior to producing documents and written responses to demands because the Staff never advised Respondents of its existence.

Had the Staff sought the information it demanded from Respondents through subpoenas and recorded testimony, as the issuance of a Formal Order presumes, Respondents would have been afforded the due process procedural mechanisms provided in the investigative process, including being advised of significant constitutional rights. See *Securities and Exchange Commission v. Wheeling-Pittsburgh Steel Corp.*, 648 F.2d 118, 127 (3rd Cir. 1981)("Under the SEC's own regulations, it may conduct two types of investigations. A preliminary investigation, in which no process is issued or testimony compelled is proper whenever 'it appears that there may be (a) violation (citing) 17 C.F.R. § 202.5(a). A formal investigation, in which process may be used, may be ordered by the Commission if it appears from the information obtained that there is a likelihood that a violation has been or is about to be committed and that the issuance of process may be necessary.").

Instead, the Staff demanded that Respondents produce documents and evidence without advising them of certain rights, including due process rights, attached to the demands. The Staff's actions knowingly misled Respondents about the purpose of the deficiency letters and information requests. See *Securities and Exchange Commission v. ESM Government Securities, Inc.*, 645 F.2d 310 (5th Cir. 1981)(abuse of process where SEC knowingly misled broker/dealer about the purposes of its review of files and broker/dealer was misled); *Securities and Exchange Commission v. Cuban*, 798 F. Supp.2d 783 (N.D. Tex. 2011)(unclean hands defense available in SEC enforcement action where SEC conduct is egregious, misconduct occurs before the enforcement action, and the misconduct results in prejudice to the defense of the enforcement action that rises to the constitutional level).[19]

ARGUMENT

A. The Division Cannot Establish A Violation Of Section 206(1), 202(2), Or 206(4) Of The Advisers Act.

Sections 206(1), 206(2), and 206(4) of the Advisers Act, 15 U.S.C. § 80-b-6, provide in pertinent part:

> It shall be unlawful for any investment adviser by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

[19] This is but one of several instances in which the Staff has used questionable tactics to attempt to build a case against Respondents. For example, after Respondents provided their Wells Submission, the Staff cold-called certain RJLWM clients and misrepresented to such clients that RJLWM had provided their personal contact information to the Staff. This led to tremendous client concern that their personal information had been compromised. As discussed above in Footnote 2, the Staff also contacted a plaintiffs class action law firm in an attempt to locate seminar attendees who might be willing to testify that the BOM seminars were misleading. Further, it is surprising that the Division would allocate the significant resources it did to obtain Mr. Grenadier's expert research and report months before filing the OIP. (Deposition of Steven Grenadier ("Grenadier Depo."), p. 8, l., 14-p. 10, l. 17)

> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;
> (2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;
> (4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Rule 206(4)-1 is the principal rule by which the Commission regulates advertisements under the Advisers Act. Rule 206(4)-1 contains four specific prohibitions and one catchall provisions. 17 CFR § 275.206(4)-1. Specifically, Rule 206(4)-1(a)(5) makes it a violation of Section 206(4) for an investment adviser to publish, circulate, or distribute any advertisement which contains any untrue statement of material fact or which is otherwise false or misleading.

To establish that RJLC violated Section 206(1) of the Investment Advisers Act, the Division must prove that (1) RJLC was an investment adviser; (2) RJLC utilized the mails or instrumentalities of interstate commerce to employ a device, scheme or artifice; (3) the device, scheme or artifice violated RJLC's fiduciary duty to its clients or prospective clients in that it made false and misleading statements to its clients or prospective clients; and (4) RJLC acted with scienter. *Morris v. Wachovia Sec., Inc.*, 277 F. Supp.2d 622, 644 (E.D. Va. 2003).[20] The same elements apply for Section 206(2), except that no scienter is required. All that need be shown is that the investment adviser failed to disclose a material fact. *Morris, supra,* at 644. *See*

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[20] Scienter is required to establish violations of Section 206(1) of the Advisers Act. *SEC v. Steadman*, 967 F.2d 636, 641 & n.3 (D.C. Cir. 1992). It is "a mental state embracing intent to deceive, manipulate, or defraud." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); see also *Aaron v. SEC*, 446 U.S. 680, 686 n.5, 695-97 (1980); *SEC v. Steadman*, 967 F.2d at 641. Recklessness can satisfy the scienter requirement. *See David Disner*, 52 S.E.C. 1217, 1222 & n.20 (1997); *see also SEC v. Steadman*, 967 F.2d at 641-42; *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990). Reckless conduct is conduct which is "'highly unreasonable' and . . . represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.'" *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977)).

also, SEC v. Merrill Scott & Assoc., Ltd., 505 F. Supp. 2d 1193 (D. Utah 2007); *Wall Street Publishing Institute, Inc.*, 591 F. Supp. 1070 (D.D.C. 1984); *In the Matter of Pelosi*, Initial Decision Release No. 448 (Jan. 5, 2012). "The standard of materiality is whether or not a reasonable investor or prospective investor would have considered the information important in deciding whether or not to invest." *In the Matter of Brandt, Kelly & Simons LLC*, Initial Decision Release No. 289 (June 30, 2005) citing *SEC v. Steadman*, 967 F.2d 636, 643 (D.C. Cir. 1992), *see also*, *SEC v. Slocum*, 34 F. Supp. 2d 144 (D.R.I. 2004). The Division has the burden of proof of each claim, and must prove each element by preponderance of the evidence. *See Steadman*, *supra*, 450 U.S. at 96.

Because Rule 206(4)-1 does not expressly prohibit performance advertising, the Division has attempted to regulate performance advertising under the catchall provision by deploying a draconian regime of unworkable guidelines through a series of interpretative letters beginning with the often cited *Clover Capital Management, Inc.*, 1986 WL 67379 (SEC No Action Letter Oct. 28, 1986). *Clover*, which is entirely distinguishable from the facts here, addressed a situation where a registered investment adviser advertised investment results derived from a "model" portfolio. Importantly, in *Clover*, the "Model Portfolio" purchased and sold **specific identified securities which mirrored the securities purchased and sold in client accounts.** In *Clover*, the staff set forth a list of advertising practices it believed were inappropriate with respect to advertising model and actual results. However, neither *Clover* nor any other reported decision, no-action letter or offer of settlement addressing "model" or performance advertising applies the Staff's interpretation to advertising related purely to an investment strategy that does not identify any specific security, portfolio, account or asset that a potential purchaser could actually purchase. To be clear, even if a seminar attendee wanted to replicate the BOM strategy and "model" the investments, he or she would not be able to do so as there are no specific securities identified. As such, the slides that the Division complains of are not advertising "model" performance and *Clover* is inapplicable.

Moreover, *Clover* is not the law. As Administrative Law Judge Kelly observed in *In the Matter of FXC Investors Corp. et al.*, Initial Decision Release No. 218 (December 9, 2002), 2002 WL 31741561, *10, apart from two cases there is an absence of "genuine precedent on the subject of performance advertising by investment advisers." Those cases, decided over a decade after *Clover*, do not mention, let alone validate, the Division's views in *Clover*. See, *Valicenti v. SEC*, 198 F.3d 62, 63 (2d Cir. 1999); *In re Seaboard Investment Advisers, Inc.*, Initial Release No. 149 (Sept. 21, 1999) 1999 WL 735233. "With two exceptions that are not relevant here, the Commission has not engaged in notice and comment rulemaking to amend Advisers Act Rule 206(4)-1 since 1961." *FXC Investors*, 2002 WL 31741561 at *10. The *FXC Investors* court recognized that, as surely will happen here, the Division "attempts to fill the void by citing to settled cases[] [and] staff no-action and interpretive letters..." *Id.* "This 'precedent' is of limited value here." *Id.*

"In the absence of an opinion stating the Commission's views on the issues raised, settlement[] [orders] are of dubious value as precedent. Settlements involving so-called 'speaking orders' are particularly suspect." *Id.* (citation omitted) Similarly, courts "will not accord great deference" to no action letters that "did not go through notice and comment." *N.Y. City Employees' Ret. Svs. v. SEC*, 45 F.3d 7, 14. "Staff interpretations contained in opinion letters do not warrant judicial deference, are not binding on the courts, and have no value beyond their own persuasive weight." *FXC Investors*, 2002 WL 31741561 at *11 (internal citations omitted).[21]

Clover and its progeny should not guide this Court's decision in this case, particularly because the Division's views regarding performance advertising have been unstable, evolving from a chilling *per se* ban to a facts and circumstances test that is overshadowed by an impracticable eleven-headed hydra. *See Clover, 1986 WL 67379* (explaining the Division's reevaluation of its former view that performance advertising was *per se* fraudulent). By its own terms, *Clover* is only applicable to advertisements that portray the actual or model performance of an actual or model portfolio. Therefore, it is inapplicable here because the hypothetical illustrations at issue do not purport to relate to the performance of any actual or model portfolio.

1. The BOM Strategy Is Not A Model Portfolio.

The BOM strategy is a retirement asset withdrawal strategy, not a formulaic model. The difficulty in recognizing the BOM strategy as an investment philosophy rather than a mechanical formula may be best evidenced by the fact that the Division previously reviewed the identical hypothetical as part of the 2003 Examination and raised no alarms - or mention - regarding its potential to mislead investors. To the contrary, the Division tacitly approved of the 1973 hypothetical slides. It stands to reason that had the Division in 2003 considered the hypothetical a "back-test," as that term is defined in the OIP, of a model portfolio, it would have attempted to

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[21] This is because "staff no-action and interpretive letters are not expressions of the Commission's views and do not have the force of law. As the Commission itself has noted, no action and interpretive responses by the staff are subject to reconsideration and should not be regarded as precedents binding on the Commission." *Id.* (internal citation and quotations omitted); *N.Y. City Employees' Ret. Svs., supra,* 45 F.3d at 12-13 (2d Cir. 1995) (no-action letters do not amount to an official statement of the SEC's views); *Public Availability of Requests for No Action and Interpretative Letters and Responses Thereto by the Commission's Staff*, Release No. 5098 (Oct. 29, 1970). Accordingly, "rules announced in no-action letters also have no binding authority." *N.Y. City Employees' Ret. Svs.*, 45 F.3d at 14. Importantly, "[e]ven when the federal courts rule in accord with no-action letters, they almost always analyze the issues independently of the letters." *FXC Investors,* 2002 WL 31741561 at *11; *N.Y. City Employees' Ret. Svs.*, 45 F.3d at 13.

constrain its use under *Clover* or at least requested that Lucia cease using the slides. The hypothetical illustration has not changed from 2003; the 2003 slide was titled "Back Tested Buckets," assumed the same 3 percent inflation rate, 7.75 percent REIT distribution rate and did not deduct transaction fees or costs. Yet from one examination to the next, it has gone from not worthy of mention to the focal point of an enforcement action which has decimated Lucia's professional career. Perhaps the 2003 Examination staff considered the disclosure on the same slide that it was a "hypothetical illustration and not representative of an actual investment." What is clear is that from one examination to the next, the Staff of the same regional office came to two completely opposite conclusions as to whether the hypothetical illustrations are a "back-test" of a model portfolio.

Although of limited, if any, precedential value, the settlement orders adopting the Staff's view of violation of model performance advertising, further demonstrate that in comparison to the enforcement actions historically brought by the Division, the slides do not advertise model performance. See *In re Patricia Owen-Michael*, Advisers Act Release No. 1584 (September 27, 1996); *In Re LBS Capital Management, Inc.*, Advisers Act Release No. 1644 (July 18, 1977); *In re Shield Management Co.*, Advisers Act Release No. 1871 (May 31, 2000); *In re Market Timing Systems, Inc. et al.*, Advisers Act Release No. 2047 (August 28, 2002). In *Owen-Michael*, the advertisement compared investments in **specific mutual funds** selected by the adviser to the S&P; in *LBS*, the advertisement identified **specific equity mutual funds** to advertise model market timing services; in *Schield* and *Market Timing*, the advisers failed to disclose that **actual performance of client accounts** was materially less than the models' hypothetical results for the period. Here, there was no representation of any actual trading or any purported performance by any client account or in any specific investment. Nor could there have been as the asset-types for each bucket were too general, i.e. REIT, "stocks," T-Bills, etc. [22]

2. The Hypothetical Illustrations Are Not "Back-Tests".

RJLC concedes that it used the term "Back Tested Buckets" on one of the 127 PowerPoint slides that include the hypothetical illustrations at issue. Respondents concede that the hypothetical illustrations are not "back-tested" as that term is now defined by the Division and its expert. To be sure, with the benefit of hindsight, a better choice of words could have been used, but any seminar attendee who saw the slide in the context of the oral presentation that accompanied it was aware that it was not a "back test" as now defined by the Division.

First, the slide at issue, and many others in the slide presentation, clearly state,

> **This is a hypothetical illustration and is not representative of an actual investment.** An investor's results may vary. Past performance does not guarantee future results. This example uses actual treasury rates of return to calculate fixed income/bond returns and actual S&P 500 returns to calculate growth returns. **An investment may not be made directly in an index.**" (emphasis added).

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[22] Historically, the Division has recognized the distinction between general investment strategies and model performance. In SEC Release No. 563, *Applicability of Investment Advisers Act to Certain Publications*, dated January 10, 1977, the Division announced that it was eliminating one category of authors from registration under the Advisers Act. In support of its announcement, the Division stated that it had "for many years taken the position that publication of a single book, pamphlet, or article of an investment advisory nature would not normally require an author or publisher to register as an investment adviser where (1) the publication did not contain recommendations, reports, analyses, or other advisory information relating to specific securities or issuers, (2) the publication was not one of a series of publications or intended to be supplemented or updated, and (3) the publication did not contain one or more investment formulae, or for other reasons appear likely to be sold or used continuously or indefinitely, provided that the author did not engage in other activities which would bring him within the definition of investment adviser." *Id.*

However, the Division reconsidered its long standing position and "concluded that registration under the Act should not be required solely because a publication contains one or more formulae or guidelines intended to be used by investors in making determinations as to what securities to buy or sell or when to buy or sell them." *Id.* The Division stated that "[f]rom an administrative standpoint, difficulties have arisen in distinguishing between essentially mechanical formulae or guidelines, and those more general investment philosophies, techniques or analytical approaches for which registration under the Act has not normally been required in the absence of other factors." *Id.* This administrative difficulty led the Division to eliminate an entire category of authors from registration, and has now come to a head in this case.

Second, the clear and stated purpose of the hypothetical illustration presented was not to advertise the performance of any managed account, actual investors, or the performance of any securities that the attendees could purchase, but instead to compare the asset longevity of the BOM retirement withdrawal strategy to other retirement strategies. Third, it was made clear to the attendees that the hypothetical illustrations at issue could not have been "back tests" in the technical, academic sense the Division seeks to apply as an investor could not have made the "investments" as described, i.e. an investment in the S&P 500. Fifth, and most importantly, the seminar attendees did not see the slide presentation in a vacuum, but instead saw the slide presentation in conjunction with Lucia's oral presentation during which he made clear that the hypothetical illustrations were not and could not be "back tests" when he explained the various and numerous categories of assets and withdrawal requirements.

The Division would have preferred graphs and charts using inflation rates and REIT returns that changed from year to year, much like the ones the Divison's expert, Mr. Grenadier submitted in his expert report, but the seminars were not symposia and the seminar attendees were not academics versed in polynominal approximations or stochastic differential equations. These were middle class retirees with average retirement savings of $250,000 to $1 million. The level of specificity demanded by the Division would confuse the average retiree and defeat the purpose of the exercise – a basic comparison of multiple withdrawal strategies. The elementary nature of the hypothetical is even apparent in the inputs it uses such as "bonds," "stocks," "REITs," and "CDs." (Respondents' Exhibit 3, RJL-SEC-0000435). The hypothetical does not specify a type of bond, any particular stock, an identifiable REIT, or an institution's certificate of deposit – all particulars required under the Division's definition of a "back test" of a model portfolio. Indeed, one of the inputs is a stock index, which, as disclosed, is not something that can even be purchased. No reasonable person could have walked away from these seminars believing he or she had just reviewed a historical simulation of a model portfolio.

While the Division hopes this Court will put blinders on and ignore the content of the presentation, Lucia made repeated disclosures that the illustrations were hypotheticals and any attendee who heard Lucia's presentation would have understood the hypothetical illustrations were was not "back tests" using the Division's definition.

3. Use Of An Assumed Inflation Rate Was Not Misleading.

Apparently as a result of their expert's months of research and opinion, and after Respondents made a Wells Submission responding to the alleged misleading inflation rate, the Division's position concerning the inflation rate that Lucia should have used to make the hypothetical not misleading – and a true "back-test" – has shifted significantly. In the December 17, 2010 deficiency letter, the examination Staff asserted that the "actual average inflation rate for the period beginning January 1, 1966 and ending December 31, 2003 was 4.8%, but the back-tested portfolio assumed a constant inflation rate of 3%, without disclosing the actual inflation rate for the period or the effect of the actual inflation rates on portfolio performance." (Respondents' Exhibit 6) This theory, that Respondents should have utilized an average inflation rate of 4.8% instead of 3%, comports with the Division's position as articulated during the examination and investigation.

For the purposes of the OIP, the Division has radically changed its position as to the inflation rate necessary to be utilized in order for a hypothetical using a historical time period not to be misleading. Now the Division and its expert assert that Respondents misled investors by not applying the actual inflation rate for each separate year of the hypothetical. This revised view, i.e. that averages are misleading, is a position that has never been articulated by the Commission and would subject virtually every adviser that has advertised historical performance data to be in violation of Section 206.[23] Moreover, the inconsistency among the Staff, the Division and the Division's expert as to the appropriate inflation rate underscores that a reasonable (not misleading) historical rate of inflation is open to interpretation.[24]

Use of an assumed 3% inflation rate in the context at issue does not violate Section 206 for several reasons. First, during the seminar presentation, when explaining the hypotheticals, Lucia expressly tells the attendees, **"Let's pretend from that point [1966] forward inflation was 3 percent. We know it was more, but we wouldn't have known that at the time."** (Respondents' Exhibit 30 at 48:10) This statement conclusively demonstrates that the hypotheticals were not "back-tests" as that term is defined by the Division, and Lucia was not "misleading" the audience.

Second, the use of a particular inflation rate is irrelevant for purposes of the hypothetical because the same inflation rate is applied across all of the compared strategies, thereby making any comparison accurate for that purpose. As conceded by the Staff, applying an inflation rate based on the average and yearly consumer price index would have only depleted an investor's funds more quickly across all strategies, but it would have had no effect on the ultimate message – the BOM strategy preserves funds longer than the compared strategies.[25]

Second, the use of a 3% assumed inflation rate in retirement planning calculations is universally recognized. For example, as an aid to assisting seniors determine savings withdrawal rates, the AARP online "Withdrawal Estimator" assumes a 3% inflation rate. "If you want to get

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23 For example, American Funds currently has an article on the Internet which charts "Back-testing withdrawal rates on indexes" from 1961-2010 and utilizes a 4% inflation rate. (Respondents' Exhibit 46)

24 See Grenadier Depo., p. 58, l.24 – p. 61, l. 2.

25 See Deposition of Benjamin Stein, p. 54, l. 5-12.

a rough idea of how long your savings might last, choosing a withdrawal rate and a return rate, take a look at the calculator below. A 3% inflation increase is built into the assumption on withdrawals."

http://www.aarpfinancial.com/content/YourGoals/livWrkRet_setRealExpectations.cfm. Indeed, the retirement calculator for the United States Office of Personnel Management utilizes a 3% inflation rate for SEC employees retirement planning. (Respondents' Exhibit 42) The CPI-U average rate of inflation from 1913 to 2010 is 3%.[26] This is relevant because during the seminars, Lucia makes clear that in discussing the 1973 and 1966 hypotheticals, he is using **forward looking** factors in the hypotheticals. (Respondents' Exhibit 30 at 48:10)

Third, even the SEC's expert admits that the actual historical rate of inflation is disputed among economists and academic scholars. The highly regarded Boskin Commission Report published in 1996 recommended downward adjustments in the CPI of 1.1%. (Respondents' Exhibits 39, 40).[27] Most of the Boskin Commission recommendations were implemented by the Bureau of Labor Statistics.[28] In addition to the CPI-U data, the Division's expert's report also posits that Respondents should have calculated the hypotheticals using the CPI-E (Experimental). (Division Exhibit 70, SEC EX009-010, 035-36)

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[26] ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt

[27] The Boskin Commission concluded "Changes in the CPI have substantially overstated the **actual rate of price inflation**, by about 1.3 percentage points per annum prior to 1996. . . .It is likely that a large bias also occurred looking back over at least the last couple of decades."(emphasis added) (Respondents' Exhibit 39)

[28] A subsequent 2006 study published by the National Bureau of Economic Research and authored by Boskin Commission member Robert Gordon, concludes that in retrospect, the Boskin Commission should have recommended a 1.2 to 1.3 percent downward adjustment to the CPI. (Respondents' Exhibit 40) In addition, in 2002, the U.S. Bureau of Labor Statistics ("BLS") began publishing a consumer price index called the Chained Consumer Price Index for All Urban Consumers, designated the C-CPI-U, which is designed to be a closer approximation to a "cost of living" index than existing BLS measures. Further, a March 2010 Report published by the BLS found that average annual expenditures dropped substantially during retirement years.(Respondents' Exhibit 43)

While this makes for an interesting academic conversation among Ph.D. level economists, it was not relevant to the hypothetical illustrations Lucia presented during his seminars. Lucia used an assumed 3% inflation rate as a constant factor to compare the various retirement strategies to BOM. As such, the use of a disclosed "assumed" 3% inflation rate in the hypothetical illustrations was not misleading and did not violate Section 206 of the Advisers Act.

4. Use Of An Assumed REIT Rate Of Return Was Not Misleading.

For many of the same reasons stated above, it similarly was not misleading to disclose and utilize an "assumed" REIT rate of return. Further, because Lucia did not identify a specific real estate investment, it would be impossible to apply an actual annual historical rate of return in the manner urged by the SEC's expert. No reasonable investor or prospective investor would have thought that the "REIT" factor used in the hypothetical was an investment in a specific REIT. During the seminar, Lucia makes clear that he is advocating that investors invest in "direct ownership in real estate" as an asset class for diversification. (Respondents' Exhibit 30, at 33:13)

Moreover, the December 17, 2010 deficiency letter and the OIP do not take a position as to the REIT return rate Lucia should have utilized for the hypotheticals. Instead, the OIP simply asserts that the Respondents failed to disclose that the REIT rates of return were "entirely hypothetical." Respondents will present conclusive evidence that during the seminar, there were repeated disclosures that the illustrations were hypotheticals, including the fact that the slides so state, and will present expert testimony that the assumed REIT rate of return was reasonable, and therefore not misleading. When the slides are viewed in their totality and within the context of the oral presentation, which the slides are designed to supplement not supplant, there is nothing misleading about assumed REIT rates of return, why they are assumed, and what results when you apply them consistently across the varying investment strategies. Accordingly, the use of a disclosed "assumed" REIT rate of return in the hypothetical illustrations was not misleading and did not violate Section 206 of the Advisers Act.

5. The Hypotheticals Were Not Misleading Concerning Advisory Fees.

The Division claims that it was materially misleading to fail to disclose to investors that the hypothetical illustrations did not deduct advisory fees.[29] To allege this claim, the Division goes through an exceedingly tortured analysis. According to the OIP, certain spreadsheets ("Spreadsheets") prepared by Respondents did not include deductions for advisory fees, and because those Spreadsheets are alleged to have "tested" the 1973 and 1966 hypotheticals, and because these hypotheticals do not deduct advisory fees, the hypotheticals misled investors.

First, at each seminar, Lucia specifically disclosed that "there are fees and expenses associated with investing in mutual funds, including portfolio management fees and expenses and sales charges." (Respondents' Exhibit 3, SEC-LA3937-00093) The PowerPoint presentation also urged the attendees to "please consider the investment objectives, risks, charges and expenses carefully before investing." *Id.* No attendee was misled as to advisory fees as there was no assertion that advisory fees had been deducted.

Second, deducting a model fee would have been impossible because the hypothetical illustrations did not describe the investments sufficiently to assign a cost or a fee. Indeed, it

[29] This requirement that performance information must be presented net of fees is entirely a Division construct under *Clover*. Thomas P. Lemke, Regulation of Investment Advisers § 2:75 (2012) ("prior to Clover it was generally understood that an advertisement would not be *per se* fraudulent if it included gross performance results and separately disclosed the range or amount of fees an investor would have incurred"). It is also a prime example of how the Division's views regarding performance advertising remain unsettled after *Clover* In *Clover*, the Division took the uncompromising position that performance information must reflect the deduction of actual advisory fees. Ten years later, the Division reversed its position and stated that performance information could reflect a model fee if the result was no higher than if actual fees had been deducted. *J.P. Morgan Investment Management, Inc.* (SEC No-Action Letter May 7, 1996).

would be impossible, and therefore misleading, to deduct a fee for an undefined REIT or T-Bill investment. Further, deducting a transaction cost for an investment in the S&P 500, an index which Lucia specifically disclosed could not be purchased, would have been similarly misleading.

Moreover, it would be impossible, and therefore misleading, to advise investors that a specific advisory fee or transaction cost would necessarily apply to the BOM strategy.[30] The BOM strategy is an asset withdrawal methodology which requires an individually customized portfolio dependent on a number of factors, including income need, assets, savings, time horizon, risk tolerance, tax bracket, investment mix, etc. Any potential investor who later met with a RJLC adviser received full disclosure of transaction costs and advisory fees at the time they signed their client agreement. In asserting this allegation, the Division wholly ignores that in the event a seminar attendee chose to meet with an RJLC adviser and became a RJLC client, all fees and transaction costs associated with the specific investments they chose were fully disclosed. For example, if an RJLC client determined, after meeting with an RJLC adviser, that a REIT investment made sense for his or her retirement needs, the RJLC adviser acting in his or her separate capacity as a registered representative of an (unaffiliated) broker/dealer would provide the client with a prospectus setting forth, among others, any fees or costs associated with the specific REIT. The Staff examined RJLC in 2003 and 2010 and did not find any deficiencies with respect to disclosure to clients of transaction fees and costs.

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[30] In its December 17, 2010 deficiency letter, the Staff asserts that they applied a 1% annual management fee to the 1966 through 2003 illustration, resulting in a different outcome than Lucia's calculation. Application of a 1% annual management fee, which may have little or no relevance to an individual's implementation of the BOM strategy, would arguably be more misleading than not including advisory fees as an assumption. For example, fees and costs associated with the safer all CD – type strategy could have potentially been much lower than fees and costs for implementing the BOM strategy so that applying a 1% transaction fee actually could have been misleading.

Further, the information provided at the BOM seminars can and has been used by investors who implement their own BOM strategy using online research and trading, thereby reducing or completely eliminating advisory fees and transaction costs. In sum, as Lucia previously testified, disclosing transaction or advisory fees is impossible where the strategy is not based on a "model portfolio" and does not identify specific investments, securities or brokerage products.

Finally, although the Division must desperately cling to the Spreadsheets to give their claim an aura of validity, the fact is, no attendee ever saw the Spreadsheets, and, as shown below, because the spreadsheets do not demonstrate the calculation of the performance or rate of return of any *managed accounts or securities recommendations* the maintenance of such records was not required. The Division's attempt to use calculations such as those in the Spreadsheets as the basis for a Section 206 violation is unprecedented and without merit.

B. RJLC Cannot Be Liable For A Violation Of Section 206(1) Because It Did Not Act With Scienter.

In order to establish scienter, the Division must prove that RJLC "acted with an intent to deceive, manipulate or defraud." *Moran, supra*, 922 F. Supp. at 896-97. This is a standard the Division has no hope of proving. First, when viewed in the context of the seminar presentation, as it should be, the slides at issue are not misleading and clearly demonstrate an educational presentation on retirement planning. Lucia goes to great lengths to make repeated disclosures concerning the economic factors utilized in the illustrations. Accordingly, there was no misrepresentation, let alone an intentional or reckless misrepresentation. Second, there were no red flags that the seminar presentation, including the slides, was in any way misleading. The Pacific Regional Office examined the identical slides at issue in 2003 and made no mention that the slides were misleading or even potentially misleading. All of the marketing materials utilized by RJLC including the slide presentation, were reviewed by RJLC's broker dealer for FINRA advertising compliance purposes.[31] Further, RJLC has never received a complaint from any seminar attendee that he or she found the seminar presentation or the hypothetical illustrations misleading, nor can the Division offer evidence of any.

Third, as demonstrated above, there is and always has been a shortage of genuine precedent to guide investment advisers as to what is legally prohibited under performance advertising. The Division's reliance on no-action and interpretative letters only proves that the Division agrees with itself as to what is prohibited. A reasonable interpretative disagreement with the Division cannot form the basis of reckless conduct. Accordingly, the Division cannot prove that RJLC had the requisite mental state for a Section 206(1) violation.

Here, the Division is advocating plucking from an hour-long seminar presentation a single PowerPoint slide which uses the term "back-test." As discussed, there are a very limited number of reported decisions addressing violations of Section 206(1) based on performance or model advertising. However, the cases that do discuss such violations make clear that to determine whether an advertisement is materially false or misleading, the facts and circumstances surrounding the advertisement should be considered. In *In the Matter of Valicenti Advisory Services, Inc.*, Initial Decision No. 111 (July, 2, 1997), the ALJ found "[w]hether any communication is, or is not, misleading **will depend on all the particular facts**, including (i) the

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31 Both the November and December Reports for the 2010 Examination state

> [t]he examination disclosed that RJL submitted the marketing materials above to [its broker/dealer] First Allied for review and approval. However, it appears that First Allied did not test the accuracy of any performance returns presented in the marketing materials, and the First Allied review did not identify any of the marketing issues discussed above. The staff believes that an effective review of the marketing materials and the performance returns presented therein could have prevented the advertising issues discussed above, and the staff is bringing this to RJL's attention as a weakness in its compliance program.

form as well as the content of a communication; (ii) the **implications or inferences arising out of the communication in its total context**; and (iii) the sophistication of the prospective client." (emphasis added); *see also*, *Seaboard Investment Advisers, Inc.*, *supra*, (evaluating factors indicating that respondents' conduct was not driven by desire to defraud or injure clients). A finding that the hypothetical illustrations were materially misleading for the purpose and context in which it was communicated would simply be unprecedented. *See e.g.*, *In re Leila C. Jenkins*, Initial Decision Release No. 451 (Feb. 14, 2012) (investment adviser promoted a fabricated client); *In re Bond Timing Services, Inc. et al.*, Advisers Act Release No. 920 (July 23, 1984) (advertising hypothetical returns based on a timing system no longer in use by the adviser); *In re Cambridge Equity Advisors, Inc. et al*, Advisers Act Release No. 2001 (Dec. 12 2001) (adviser combined model performance results with actual performance results); *In re Bell Capital Management, Inc.*, Advisers Act Release No. 1813 (Aug. 6, 1999), 1999 WL 641795 (brochure included back-tested results where the only discussion of the hypothetical nature of the results was on an unnumbered page in the last section of the brochure); I*n re Hazel B. Canham D/B/A Canham & Canham Associates*, Advisers Act Release No. 1386 (Sept. 30, 1993), 1993 WL 393540 (advertisement published a composite record that overstated actual performance by 12%-29%); *In re Willam J. Ferry*, Advisers Act Release No. 1747 (Aug. 19, 1998), 1998 WL 487681 (marketing timing system advertisement failed to disclose that the performance results were hypothetical and not actual); *In re Meridian Investment Management*, Advisers Act Release No. 1779 (Dec. 28, 1998), 1998 WL 898489 (advertisement falsely stated that client performance results of a sector rotation technique were calculated on a post fee basis); *In re Independent Financial Group*, Advisers Act Release No. 1891 (August 8, 2000), 2000 WL 1121531 (advertisement claimed that performance results were based on composite portfolios despite the fact that the adviser did not have any clients); *In re Consolidated Financial Advisors*, Advisers Act Release No. 1672 (Sept. 26, 1997), 1997 WL 593966 (advertisement represented a third party's performance as the adviser's own); *In re Jason A. D'Amato*, Advisers Act Release No. 3455 (Aug. 31, 2012), WL 3775898 (client performance data presented as "historical performance data" was a combination of historical, back-tested and hypothetical a data).

SEC v. Slocum, 334 F. Supp.2d 144 (D.R.I. 2004) provides an additional ground for a finding that Respondents did not act with the requisite scienter. In discussing whether an aiding or abetting violation of Section 206 of Advisers Act had occurred, the court held individual respondents did not act with scienter because neither the SEC or the firm's external auditors identified the firm's account structure as a potential problem. *Id.* at 185. "The evidence demonstrated that when potential compliance issues were brought to [the firm's] attention, [the respondent partner] took steps to remedy the situation by reformulating [the firm's] practices." *Id.*

The similarities of *Slocum* and this proceeding are unmistakable. As in *Slocum*, the Division examined extensively RJLC's business practices previously, including the slide presentation, and expressed no negative comment as to the use of the slides that are now at the forefront of this enforcement action. As in *Slocum*, Respondents assumed the slide presentation complied with all federal securities laws because the Division's previous examination failed to identify previously the slides as even potentially misleading. As in *Slocum*, Respondents responded to the Division's examination deficiency letters and immediately took remedial steps to cure any deficiencies.

For the foregoing reasons, RJLC has not violated Section 206(1).

C. RJLC Cannot Be Liable For A Violation Of Section 206(2) Because It Did Not Act With Negligence.

Recognizing that a finding of negligence will satisfy a finding of liability under Section 206(2), the Division will not be able to meet this burden. When considered in context with the seminar presentation, the hypotheticals at issue were not misleading. Attendees at the seminars understood that Lucia was comparing the difference in the longevity of retirement assets where there is a withdrawal of less risky assets before a withdrawal of riskier assets. That is all. Lucia's presentation did not promote any specific assets or security, did not present performance calculations for any portfolio or managed account, and only discussed general asset categories. Lucia repeatedly advised the attendees that the BOM strategy was specific to each individual's income needs and retirement assets. No misstatement or omission of material fact was made to the attendees and no investor was misled. For the foregoing reasons, RJLC has not violated Section 206(2).

D. Rule 204(4)-2(a)(16) Is Inapplicable Here Because The Hypothetical Illustrations Do Not Present Performance Or Rate Of Return Of Any Managed Account or Securities Recommendation.

Rule 204(4)-2(a)(16) requires that an investment adviser maintain:

> all accounts, books, internal working papers, and any other records or documents that are **necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all *managed accounts or securities recommendations* in any notice, circular, advertisement,** newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with the investment adviser)… (emphasis added)

In other words, investment advisers must maintain records supporting the calculation of actual performance of managed accounts or securities recommendations. The hypotheticals presented in the seminars did not calculate the performance of either managed accounts or securities recommendations, therefore there is no requirement that any records be maintained to support the hypotheticals. Accordingly, this claim should be dismissed.

The OIP alleges: "At its seminars, RJLC presented performance calculations for several strategies which purport to demonstrate the superior performance of the BOM strategy over certain periods." This is not the standard and there are no reported cases, SEC No-Action letters or settlement orders in which the Division or the Commission has taken the position asserted here. *See*, *Salomon Brothers Asset Management, Inc. et al.*, 1999 WL 528854 (SEC No-Action Letter July 23, 1999)(confirming that published materials listing the net asset values of a **managed account**, together with worksheets that demonstrate the calculation of performance information based on those net asset values, would demonstrate the calculation of performance information under Rule 204-2(a)(16)); *Jennison Associates LLC*, 2000 WL 896020 (SEC No-Action Letter July 6, 2000) (recommending advisers maintain third-party records prepared by independent auditors to confirm the accuracy of internally generated records of **managed accounts**); *In re Hazel B. Canham D/B/A Canham & Canham Associates*, Advisers Act Release No. 1386 (Sept. 30, 1993), 1993 WL 393540 (adviser failed to maintain any records which provided the basis for her calculation of her advertised **composite rate of return for all accounts managed by her**); *In re Lynn Elgert, Inc.*, Advisers Act Release No. 1339 (Sept. 21, 1993), 1992 WL 252172 (failed to maintain records necessary to demonstrate the calculation of the **performance of managed accounts**); *In re Oxford Capital Management et al.*, Advisers Act Release No. 2138 (June 24, 2003), 2003 WL 2381682 (failed to maintain records demonstrating the calculation of the **rate of return** for a **composite of managed accounts** supporting "'Top 20' ranking"); *Horizon Asset Management, LLC*, 1996 WL 554956 (SEC No-Action Letter Sept. 13, 1996) (record keeping requirement applies to use of predecessor firm's performance data of

managed accounts); *Great Lakes Advisors, Inc.*, 1992 WL 105179 (SEC No Action Letter Apr. 3, 1992); *In the Matter of Calhoun Asset Mgt.,* Advisers Act Release No. 3428 (July 9, 2012) (failed to maintain records demonstrating **performance returns for two managed hedge funds**).

As Respondents have repeatedly demonstrated to the Division, Rule 204(4)-2(a)(16) simply does not require that RJLC maintain books and records for calculations that do not demonstrate the performance or rate of return of any *managed account or securities recommendations*. Accordingly, RJLC has not violated Rule 204(4)-2(a)(16).

E. The Division Cannot Establish That Lucia Willfully Aided And Abetted RJLC In Violating Section 206(1)-(2) And (4) Of The Advisers Act.

In order to establish a claim for aiding and abetting, the Division must establish: (1) the existence of a securities law violation by the primary party; (2) "knowledge" of the violation on the part of the aider and abettor; and (3) "substantial assistance" by the aider and abettor in the achievement of the primary violation." *Metge v. Baehler*, 762 F.2d 621, 624 (8th Cir. 1985). "Irrespective of the level of proof required to establish the primary violation, the Commission has made clear that the accused aider and abetter must have acted with scienter." *In re FXC Investors Corp et al., supra,* 2002 WL 31741561, *9. Respondents have fully addressed the first element above. Therefore, they reserve their analysis to the knowledge and substantial assistance elements here.

"[A]ctions against aiders and abettors of the securities laws, makes clear that the requisite scienter for aiding and abetting liability is 'knowingly.' This requirement is in keeping with the traditional scienter necessary to give rise to aiding and abetting liability under Section 10(b)." *SEC v. Fehn*, 97 F.3d 1276, 1295 (9th Cir. 1996).[32]

"The awareness of wrong-doing requirement for aiding and abetting liability is designed to insure that innocent, incidental participants in transactions later found to be illegal are not subjected to harsh, civil, criminal, or administrative penalties. This policy is especially germane where the proscribed conduct of the principal may not always appear to be wrongful . . ." *Investors Research Corp. v. SEC*, 628 F.2d 168, 177 (D.C. Cir. 1980). "If the conduct is allegedly improper under the secondary liability theory of aiding and abetting, the protective function mentioned in *Investors Research* becomes applicable and an awareness of wrongdoing must be established." *Deckler v. SEC*, 631 F.2d 1380, 1388 (10th Cir. 1980).

For the reasons set forth above, the Division cannot prove Lucia was aware of any violation of Section 206. Moreover, even if recklessness were the appropriate standard, the

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[32] In 2010, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress amended Section 209 of the Advisers Act to relax the knowledge requirement of aiding and abetting liability to include reckless conduct. See Dodd Frank Wall Street Reform and Consumer Protection Act § 929N, Pub. Law 111-203 (2010). Section 929N of the Dodd Frank Act provides:

Section 209 of the Investment Advisers Act of 1940 (15 U.S.C. 80b–9) is amended by inserting at the end the following new subsection:

"(f) AIDING AND ABETTING.—For purposes of any action brought by the Commission under subsection (e), any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of this Act, or of any rule, regulation, or order hereunder, shall be deemed to be in violation of such provision, rule, regulation, or order to the same extent as the person that committed such violation."

Courts applying Dodd-Frank, however, have held that the statute's provisions are not to be applied retroactively. See e.g., *Mejoa v. EMC Mortg. Corp.*, No. CV 09-4701CAS(CFEx), 2012 WL 367364, *5, fn. 4 (C.D. Cal. Feb. 2, 2012); *SEC v. Daifotis*, No. C11-00137 WHA, 2011 WL 2183314, *12 (C.D. Cal. June 6, 2011). "[T]he presumption against retroactive legislation is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic. Elementary considerations of fairness dictate that individuals should have an opportunity to know what the law is and to conform their conduct accordingly; settled expectations should not be lightly disrupted." *Landgraf v. USI Film. Prods.*, 511 U.S. 244, 265, 114 S. Ct. 1483, 1497 (1994). "Accordingly, retroactivity has long been disfavored," as it should be here. *Daifotis*, 2011 WL 2183314, *13.

Division still fails to meet its burden. "Extreme recklessness - or as many courts of appeals put it, severe recklessness - may be found if the alleged aider and abettor encountered red flags, or suspicious events creating reasons for doubt that should have alerted him to the improper conduct of the primary violator, or if there was a danger ... so obvious that the actor must have been aware of the danger. It is not enough that the accused aider and abettor's action or omission is derived from inexcusable neglect. Extreme recklessness is neither ordinary negligence nor merely a heightened form of ordinary negligence. To put the matter in terms of [a securities violation], aiding and abetting liability cannot rest on the proposition that the person should have known he was assisting violations of the securities laws." *Howard v. SEC*, 376 F.3d 1136, 1143 (D.C. Cir. 2004) (internal quotations and citations omitted) (adopting a recklessness standard despite observing that recklessness is "inconsistent with the idea that knowledge of wrongdoing must be proven."). "The SEC has called this form of recklessness 'a state of mind closer to conscious intent than to gross negligence." *Id.* at fn. 10. Even circuits that accepted a recklessness standard before the enactment of Dodd-Frank articulated the knowledge requirement as "general awareness that [one's] role was part of an overall activity that is improper." *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 95 (5th Cir. 1975) ("Knowledge may be shown by circumstantial evidence, or by reckless conduct, but the proof must demonstrate actual awareness of the party's role in the fraudulent scheme."); *SEC v. Coffey*, 493 F.2d 1304, 1316 ("the accused party had general awareness that his role was part of an overall activity that is improper"); *Investors Research Corp. v. SEC*, 628 F.2d 168, 179 (D.C. Cir. 1980) ("the Commission failed to consider whether Driehaus had a general awareness that he was assisting Stowers in wrongful conduct").

"In alleging the requisite 'substantial assistance' by the aider and abettor, the complaint must allege that the acts of the aider and abettor proximately caused the harm to the corporation on which the primary liability is predicated." *Bloor v. Carro, Spanbock, Londin, Rodman, & Fass*, 754 F.2d 57, 62 (2d Cir. 1985). The *Bloor* court considered the following factors "in determining whether a defendant's conduct constitutes substantial assistance: (1) amount of assistance given by the defendant, (2) his presence or absence at the time of the tort, (3) his relation to the other person, and (4) his state of mind." *Monsen v. Consolidated Dressed Beef Co., Inc.*, 579 F.2d 793, 800 (3d Cir. 1978).

As stated above, the Division cannot reasonably contend that Lucia should have been aware that presenting the hypotheticals was aiding any wrongdoing because the examination staff reviewed the hypothetical in 2003 and did not raise any alarms that it was misleading. Had the examination team raised even a modicum of concern regarding the hypothetical during the 2003 investigation, Lucia would have responded in the same way he did during the 2010 investigation, by removing the hypotheticals from his presentation immediately. Nor was Lucia put on notice by complaining seminar attendees because there were none. Finally, as discussed below, the standard the OIP assumes to show a violation of Section 206 is a substantial change in SEC policy that has never been communicated to investment advisers.

F. Respondents Were Not On Reasonable Notice That The Commission Would Interpret Their Conduct to Violate Sections 206 or 204 of the Advisers Act.

Due process requires that "laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited." *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996) *citing Grayned v. City of Rockford*, 408 U.S. 104, 108, 92 S. Ct. 2294, 2298-99, 33 L.Ed.2d 222 (1972). "Although the Commission's construction of its own regulations is entitled to 'substantial deference,' we cannot defer to the Commission's interpretation of rules if doing so would penalize an individual who has not received fair notice of a regulatory violation." *Upton, supra,* 75 F.3d at 98, *citing Lyng v. Payne,* 476 U.S. 926, 939, 106 S.Ct. 2333, 2341-42, 90 L.Ed. 2d 921 (1986) and *United States v. Matthews,* 787 F.2d 38, 49 (2d Cir. 1986). In *Marrie v. SEC,* 374 F.3d 1196 (D.C. Cir. 2004) the D.C. Circuit recognized that "[f]air notice of the standards against which one is to be judged is a fundamental norm of administrative law: '[t]here is no justification for the government depriving citizens of the opportunity to practice their profession without revealing the standard they have been found to violate.''' *Id.* at 1206 citing *SEC v. Checkosky II,* 139 F.3d at 221, 225–26 (D.C. Cir. 1998).

In all previous model portfolio "back-testing" actions, the advertisement alleged to have been misleading purported to demonstrate performance results for managed accounts or specific securities. For example, *Valicenti Advisory Services, Inc. v. SEC,* 198 F.3d 62 (2d Cir. 1999)(advertisement purporting to show **rates of return on client portfolio** excluded certain accounts to inflate advisor's performance relative to other investment advisers); *SEC v. Richmond,* 565 F.2d 1101 (9th Cir. 1977)(adviser advertised the past performance of "Model Portfolio" which transacted in **specific stocks** without disclosing the transactions never occurred); *FXC Investors Corp. supra,* (advisers failed to disclose that **actual performance of client accounts** was materially less than the models' hypothetical results for the period); *In re Patricia Owen-Michael,* Advisers Act Release No. 1584 (September 27, 1996)(advertisement compared investments in **specific mutual funds** selected by the adviser to the S&P); *In Re LBS Capital Management, Inc.*, Advisers Act Release No. 1644 (July 18, 1977)(advertisement identified **specific equity mutual funds** to advertise model market timing services); *In re Shield Management Co.*, Advisers Act Release No. 1871 (May 31, 2000)(advisers failed to disclose that

actual performance of client accounts was materially less than the models' hypothetical results for the period); *In re Market Timing Systems, Inc. et al.*, Advisers Act Release No. 2047 (August 28, 2002)(advisers failed to disclose that **actual performance of client accounts** was materially less than the models' hypothetical results for the period).

The Commission has never articulated and the Division has never alleged a violation of Section 206 based on alleged failure to use actual annual historical rates of inflation and REIT returns in a hypothetical that does not relate to any managed account, portfolio or securities recommendation. Similarly, the Commission has never articulated and the Division has never alleged a violation of Section 204 based on alleged failure to maintain books and records necessary to form the basis for or demonstrate the calculation of the performance or rate of return of scenarios in a seminar presentation that are not related to any managed accounts or securities recommendations. Further, the Commission has never articulated and the Division has never alleged a violation of Section 206 without considering the context in which the alleged misrepresentation was made, in this case, a PowerPoint slide which served as a backdrop to a seminar presentation which fully described the hypothetical withdrawal strategy. Most notably, the Commission has never articulated and the Division has never alleged that it is misleading and a violation of Section 206 to use **average historical rates** (of inflation or return) as opposed to annual rates. Accordingly, these substantial changes in enforcement policy were not reasonably communicated to the public and, therefore, in contravention of Respondents' due process rights, they did not receive reasonable notice that their conduct might violate Sections 206 and 204 of the Advisers Act. *See Upton, supra*, 75 F.3d at 98; *Marrie v. SEC*, 374 F.3d at 1206; *SEC v. Checkosky II*, 139 F.3d at 221, 225–26. Because Respondents had insufficient notice of the standard the SEC would apply to find a violation of Sections 206 and 204, the OIP should be dismissed.

CONCLUSION

For the foregoing reasons, the evidence will demonstrate that the OIP should be dismissed.[33]

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LOCKE LORD LLP

By: Wrenn Chais

Michael F. Perlis
Wrenn E. Chais
Counsel for Respondents Raymond J. Lucia Companies, Inc., and Raymond J. Lucia, Sr.
Locke Lord LLP
300 S. Grand Ave., Suite 2600
Los Angeles, CA 90071
Telephone: 213 678 6701
Facsimile: 213 341 6701

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[33] Respondents will address the Division's inability to demonstrate the appropriateness of the remedial action sought in their post-hearing brief. *See WHX Corp. v. SEC*, 362 F.3d 854 (D.C. Cir. 2004).